Supreme Court, U.S.
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No. ____-____

In The

Supreme Court of the United States

October Term, 1993

MARY E. DODDS,

Petitioner,

vs.

CIGNA SECURITIES, INCORPORATED, CIGNA INDIVIDUAL FINANCIAL SERVICES COMPANY, INCORPORATED, CONNECTICUT GENERAL LIFE INSURANCE CO., CIGNA CORPORATION; AND MARTIN F. PALUMBOS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the one-year statute of limitations for federal securities claims brought pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 is triggered by actual notice or by inquiry notice?

2. If, as the Court of Appeals held, the one-year statute of limitations in Section 9(e) of the Securities Exchange Act of 1934 is triggered by inquiry notice, is it a question of law whether an investor is on inquiry notice of the unsuitability of a plan of investment in securities upon the receipt of prospectuses for those securities?

LIST OF PARTIES

All of the parties in the United States Court of Appeals for the Second Circuit are listed in the caption.

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SUPREME COURT OF THE UNITED STATES
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MARY E. DODDS,

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vs.

CIGNA SECURITIES, INCORPORATED, CIGNA INDIVIDUAL FINANCIAL SERVICES COMPANY, INCORPORATED, CONNECTICUT GENERAL LIFE INSURANCE CO., CIGNA CORPORATION; AND MARTIN F. PALUMBOS,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Mary E. Dodds, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this proceeding on December 14, 1993, affirming the dismissal of the Petitioner's Amended Complaint.

OPINION BELOW

The opinion of the Court of Appeals is reported at ____F.3d____, (2d Cir. 1993) and at [Current binder] Fed. Sec. L. Rep. (CCH) ¶ 98,025 at 98,329, and is reproduced in the Appendix at pp. 1-16[1].

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[1] The parenthetical signal (A-) refers to pages in the attached Appendix.

The opinion of the United States District Court for the Western District of New York is not reported and is reproduced in the Appendix at pp. 20-35.

JURISDICTION

The final judgment of the Court of Appeals was entered on December 14, 1993, and mandate was entered on January 6, 1994. The jurisdiction of this Court is invoked under 28 U.S.C § 1254(1).

STATUTE AND REGULATION INVOLVED

15 U.S.C. § 78i(e)

...No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

17 C.F.R. § 240.10b-5

Rule 10b-5 of the Securities Exchange Act of 1934 is reproduced in the appendix at p. 38.

STATEMENT OF THE CASE

On April 18 and April 24, 1990, approximately two months after her husband's death, Petitioner, Mary E. Dodds, a forty-five year old woman with a tenth grade education and four school-aged daughters, invested all her assets (approximately $445,000 of death and retirement benefits) upon the recommendation and advice of Respondent Martin F. Palumbos, a financial planner and agent of the Respondent Cigna Companies. Of the total investment, approximately $105,000 was in multiple units in five different limited partnerships (all held in an Individual Retirement Account).

Before her husband's death, Dodds had no experience with financial affairs or investment decisions. Lacking any ability or knowledge to make such decisions on her own, Dodds consulted with Palumbos, asking him to evaluate her financial needs and organize a suitable financial plan for her. Palumbos informed Dodds that after he evaluated her needs, he, together with other Cigna representatives, would decide upon the most appropriate financial plan and investments for her.

Palumbos met with Dodds on a number of occasions, giving her emotional support and assisting her in a variety of ways, including selecting a health insurance plan, and completing forms sent to her by her husband's employer. Two weeks before the initial purchases were to be made, Palumbos gave Dodds a large binder. It contained a personalized report that made estate planning recommendations, and categorized and summarized the recommended investments. The binder also contained more than 867 pages of prospectuses and marketing materials for the various products he and Cigna recommended that she purchase. None of the prospectuses contained any information to assist Dodds in determining the aggregate suitability of the recommended securities, other than each setting forth the minimum suitability standards for the purchase of units in the limited partnership in question. In each instance, minimum suitability standards were met. Palumbos assured Dodds that the securities that had been selected for her were suitable and appropriate for her financial needs and personal circumstances.

None of the prospectuses contained any information to assist Dodds in determining the aggregate suitability of the recommended securities, other than each setting forth the minimum suitability standards for the purchase of units in the limited partnership in question. In each instance, minimum suitability standards were met. Palumbos assured Dodds that the securities that

had been selected for her were suitable and appropriate for her financial needs and personal circumstances.

On the date the transactions were to be made, Dodds told Palumbos that she had tried, but that she was unable to read and understand the prospectuses given to her, but Palumbos reassured Dodds that the recommended investment portfolio was indeed suitable.

Dodds signed numerous boilerplate disclosures and subscription agreements. Palumbos neither reviewed those documents with Dodds, nor gave her an opportunity to read them. When he left, he took the signed disclosures with him. Palumbos later returned and disposed of Dodds' copies of the purchase orders and other documents, telling her they were useless.

Relying on Palumbos' expertise and assurances, and having received no information to trigger her alarm, Dodds took no further action regarding her finances until February 7, 1991, when she met with an accountant to complete her and her deceased husband's 1990 tax returns. Upon brief review of her financial information, the accountant expressed great concern about the investments in the limited partnerships, telling her that they were patently unsuitable for her.

Immediately afterwards, Dodds met with Palumbos and another financial planner to discuss her investments, and on April 1, 1991, contacted a law firm. From then until late November, that law firm corresponded with Connecticut General Life Insurance Company (one of the Cigna Companies) in an attempt to resolve her claim. In November, Dodds' attorneys advised her that they could no longer represent her because of the small size of her claim, informing her that she had until February 1992 (one year after she had first met with the accountant and actually discovered that the limited partnerships were unsuitable invest-

ments) in which to interpose any securities claims she might have against the Respondents.

Dodds immediately retained new counsel, and on February 4, 1992, Dodds filed her complaint in the United States District Court for the Western District of New York asserting federal securities claims under the Securities Act of 1933, Section 22, 15 U.S.C. § 77, as amended (the "1933 Act"), and the Securities Exchange Act of 1934, Section 27, 15 U.S.C. § 78aa, as amended (the "1934 Act"), with jurisdiction exercised pursuant to 28 U.S.C. § 1331. She also asserted state law tort and statutory claims including a claim for breach of fiduciary duty, through the doctrine of pendent jurisdiction. An Amended Complaint was filed on April 30, 1992.

On December 16, 1992, the district court issued it's Decision and Order dismissing Dodds' federal claims, and dismissing her state law claims without prejudice.[2] On appeal, the Second Circuit Court of Appeals affirmed the lower court's dismissal, holding that the statute of limitations for the 1934 Act was triggered by inquiry notice, and that Dodds' federal securities claims, in particular, the unsuitability claim brought under Section 10(b) and Rule 10b-5 of the 1934 Act, were time-barred because she was deemed to be on inquiry notice of fraud, as a matter of law, when she received her prospectuses.

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[2] On April 16, 1993, an Order denying appellant's timely motion to alter judgment was entered. That Order made final the December 16, 1992 Judgment dismissing all claims against the appellees.

REASONS FOR GRANTING THE WRIT

POINT I

THIS COURT'S DECISION IN *LAMPF, PLEVA, LIPKIND, PRUPIS & PETIGROW V. GILBERTSON,* 111 S.Ct. 2771 (1991), LEFT UNRESOLVED THE IMPORTANT ISSUE OF WHEN THE ONE-YEAR STATUTE OF LIMITATION FOR SECTION 10(b) AND RULE 10b-5 ACTIONS IS TRIGGERED, RESULTING IN A GROWING SPLIT OF AUTHORITY IN THE CIRCUITS

The basis of Dodds' Section 10(b) and Rule 10b-5 claim is that Respondents committed a fraud upon her by selling her securities (in particular, five different limited partnerships) that were, in the aggregate, unsuitable investments for her. In concluding that Dodds' claim was time-barred, the Second Circuit ignored the plain language of this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S.Ct. 2771 (1991), and held that Dodds was on inquiry notice of the fraud at the time she received her prospectuses.[3]

Under *Lampf,* this Court held that "[l]itigation instituted pursuant to § 10(b) and Rule 10b-5 therefore must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation" and discarded the application of the doctrine of equitable tolling to actions under Section 10(b), stating that it "is fundamentally inconsistent with the 1-and-3-year structure." *Lampf* at 2782. The *Lampf* Court then presciently noted that since the language in Section 13 of the 1933 Act (which governs actions brought under Section 12(2)) differed slightly from that in the 1934 Act, that "to

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[3] In *in re Ames Dept. Stores Inc. Note Litig.*, 991 F.2d 968 at 979 (2d Cir. 1993), the Second Circuit held that in *Lampf*, the Supreme Court "explicitly declined to rule on the meaning of the language variation" contained in Section 9(e) of the 1934 Act.

the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act, 15 U.S.C. §78i(e)." *Lampf* at 2782, n.9.

There are only two significant differences in language between the relevant portions of Section 9(e) of the 1934 Act and Section 13 of the 1933 Act, the most important of which is that the 1933 Act provides that either inquiry notice or actual notice can trigger the statute of limitations, while the 1934 Act only provides for actual notice.

The second significant difference is that the inquiry notice provided for in the 1933 Act applies to the discovery of an "untrue statement" or an "omission," while Section 9(e) of the 1934 Act provides for "discovery of the facts constituting the violation". The facts that constitute the type of fraud dealt with in Section 10(b) of the 1934 Act, including an unsuitability claim, are not as readily apparent as are the omission or misstatement of material fact that constitute the sole basis for a claim under Sections 11 and 12(2) of the 1933 Act. and therefore. are not amenable to an inquiry notice standard. A reasonable reading of *Lampf*, therefore, is that the statute of limitations is only triggered by actual discovery.

Despite the apparently plain mandate of this Court, the Second, Seventh and Tenth Circuits have ruled instead that the statute of limitations commences upon inquiry notice or actual notice, whichever first occurs.

This misunderstanding of *Lampf* is evident in the instant case. Judge Winter, in his discussion of what triggers the statute of limitations, relied on pre-*Lampf* Second Circuit cases that applied the equitable tolling doctrine to statutes of limitation based on

common law fraud.[4] Since the equitable tolling doctrine was specifically rejected in *Lampf*, those cases are no longer applicable to Section 10(b) actions.

Notwithstanding this logic, the Second Circuit has held that both inquiry and constructive notice are applicable to Section 10(b) claims, evidently reasoning that because *Lampf* confirmed the Second Circuit's decision in *Ceres Partners,*[5] which impliedly included the concepts of constructive and inquiry notice, *Lampf* confirmed those concepts as well. (A-8).[6]

Contrary to the Second Circuit's opinion in the instant case and in *Henley v. Slone,*[7] a careful reading of *Ceres* finds no discussion of constructive or inquiry notice, and a careful reading of *Lampf* suggests that *Ceres* was adopted solely because of its determination that a three year period of repose for Section 10(b) actions is sufficient.[8]

When invited by the Petitioner to revisit its opinion in *Menowitz* because of this inconsistency, the Second Circuit declined to do so, reaffirming that decision and its reasoning. (A-16).

Similarly, in a recent Seventh Circuit case, *Tregenza v. Great American Communications Co.*, the Court determined that *Lampf* did not address the issue of when the one-year statute be-

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[4] A-8, citing *Armstrong v. McAlpin,* 669 F.2d 79, 88 (2d Cir. 1983); *Robertson v. Seidman & Seidman,* 609 F.2d 583, 587 (2d Cir. 1979); *Arneil v. Ramsey,* 550 F.2d 774, 780 (2d Cir. 1977).

[5] *Ceres Partners v. Gel Associates,* 918 F.2d 348 (2d Cir. 1990).

[6] *See also, Menowitz v. Brown,* 991 F.2d 36, 42 (2d Cir. 1993), citing *Henley v. Slone,* 961 F.2d 23, 24 (2d Cir. 1992).

[7] *Henley v. Slone,* 961 F.2d at 24.

[8] *Lampf,* at 2781.

gins to run.[9] Although recognizing that when read literally, Section 9(e) requires actual notice to trigger the statute of limitations, and also recognizing that *Lampf* explicitly adopted Section 9(e) of the 1934 Act over Section 13 of the 1933 Act, Judge Posner nevertheless refused to give effect to the literal meaning of Section 9(e), reasoning that Congress' intent that "...inquiry notice makes sense for fraud in the sale of stock..." as he claims is evidenced by the inquiry notice requirement contained in Section 13, should be sufficient to impute the same requirement to Section 9(e) since "Section 11 and 12(2) of the 1933 Act, on the one hand, and Rule 10b-5 under the 1934 Act, on the other differ only in details."[10]

This analysis is also faulty and in direct conflict with *Lampf*. In a claim under Section 11 or 12(2) of the 1933 Act, an aggrieved person need only show material misstatements or omissions of which he was unaware. Section 11 and Section 12(2) of the 1933 Act both lack an essential element common to both common law fraud actions, and to actions under Section 10(b) of the 1934 Act. That element is scienter. Without scienter, there is no fraud. Judge Posner's conclusion that the differences between the 1934 Act and the 1933 Act are insignificant is therefore in error.[11]

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[9] *Tregenza v. Great American Communications Co.* [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,010 at 98, 265 (7th Cir. 1993) (stating that footnote 9 was only "dicta").

[10] *Tregenza* at 98,268.

[11] *Herman & McClean v. Huddleston*, 459 U.S. 375, 380-382 (1983).

Finally, the Tenth Circuit, in *Anixter v. Home-Stake Production Co.*, ignored the words of this Court, and held that *Lampf* generically adopted the one-year/three year scheme of both the 1993 and the 1934 Act.[12]

The Third Circuit, however, has continued to hold, consistent with its pre-*Lampf* cases,[13] that the one-year statute of limitations established in Section 9(e) for actions brought under the 1934 Act, begins to run only upon actual notice. Additionally, district courts in both the First and Ninth Circuits have held that Section 9(e) of the 1934 Act is triggered by actual notice, and not by inquiry notice.[14]

The conflict between the Circuits, and the continuing error in interpreting *Lampf* on the part of the Second, Seventh and Tenth Circuit has recently been explored in a number of scholarly articles.[15] Also instructive on the issue is the analysis contained in two

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[12] *Anixter v. Home-Stake Production Co.*, 939 F.2d 1420, 1441 (10th Cir. 1991), *on rehearing*, 947 F.2d 897 (10th Cir. 1991), *vacated*, 112 S.Ct. 1658 (1992), *on remand* 977 F.2d 1533 (10th Cir. 1992), *on rehearing*, 977 F.2d 1459 (10th Cir. 1992), *cert. denied*, 113 S.Ct. 1841 (1993).

[13] *Westinghouse Electric Corp. v. Franklin*, 993 F.2d 349 at 352, 356 (3rd Cir. 1993); *Gruber v. Price-Waterhouse*, 911 F.2d 960 at 964 n.4 (3rd Cir. 1990); *Walck v. American Stock Exchange, Inc.*, 687 F.2d 778 (3rd Cir. 1982); *In Re Data Access Systems Sec. Litig.*, 843 F.2d 1537 (3rd Cir.), *cert. denied*, 488 U.S. 849 (1988).

[14] *Slavin v. Morgan, Stanley & Co. Inc.*, 797 F. Supp. 327, 332 (D.Mass. 1992); *in re Digital Microwave Corp. Sec. Litig.*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,044 at 94,591 (N.D. Cal. 1992).

[15] Johnson, *Securities Fraud and the Mirage of Repose*, 1992 Wis. L. Rev. 607, 621-23 (1992); Simmonds, *The One-Year Statute of Limitations for Section 10(B) and Rule 10b-5 Actions: The Other View of When it is Triggered*, Volume III, No. 1 Winter 1994 Securities News 10(1994); Comment, *Triggering the One-Year Limitations on section 10(b) and Rule 10b-5 Actions: Actual of Inquiry Discovery? 30 San Diego L. Rev 917 (1993).*

other circuit court decisions which held that the one-year component of Section 9(e) is triggered only by actual notice.[16]

Just as it was of national significance to apply a uniform statute of limitations to claims brought under Section 10(b) of the 1934 Act (*Lampf* at 2779), so too it is of national significance to determine when the one-year component of Section 9(e) is triggered. Many aggrieved investors, including the Petitioner, have relied upon the plain language of this Court to their prejudice.

Others, fortunate enough to have their cause taken up by the Securities and Exchange Commission, are in the enviable position of having had their statute of limitations waived. *S.E.C. v. Prudential Securities. Inc.*, [Current Binder] Fed. Sec. L. Rep (CCH) ¶ 97,780 at 97,783 (D.D.C. 1993). Two classes of plaintiffs have thus been created, each equally the victim of pervasive fraudulent practices in the securities industry, and each practically subject to the same inquiry burden. The S.E.C.'s action points to the true difficulty of discovering fraud on the part of innocent and naive investors, and is consistent with the appropriateness of an actual discovery standard.

Clearly, the distinctions between Section 9(e) of the 1934 Act and Section 13 of the 1933 act are proving immensely significant. The growing conflict in the circuits, as well as some circuits' contradiction of the apparent plain meaning of *Lampf*, demonstrate the important need for the Supreme Court to finally determine under what circumstances the one-year statute of limitations contained in Section 9(e) of the 1934 Act is triggered, and to establish a uniform rule on which aggrieved investors can rely.

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[16] *Hauman v. Illinois Power Co.*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,882 at 93,600 (D.C. Ill. 1992); *Werner v. Satterlee, Stevens, Burke & Burke*, 797 F. Supp. 1196 (S.D.N.Y. 1992) (*Hauman* and *Werner* have been overruled by intervening circuit court decisions).

POINT II

THE DECISION BELOW, HOLDING THAT AN INVESTOR IS, AS A MATTER OF LAW, ON NOTICE OF FRAUD WHEN PROSPECTUSES ARE RECEIVED, RAISES AN IMPORTANT QUESTION OF LAW BECAUSE IT IS IN CONFLICT WITH SECTION 10(b) AND RULE 10b-5 OF THE SECURITIES EXCHANGE ACT OF 1934, AS WELL WITH PRINCIPLES OF LAW ESTABLISHED BY THIS COURT

A. The Second Circuit's Resolution of All Inferences Against the Petitioner In its Determination That She Was On Inquiry Notice Of Fraud Upon Her Receipt of Prospectuses is Contrary to The Precedent of This Court

In *TSC Industries, Inc. v. Northway,* 425 U.S. 438 (1976), this Court held that a determination of the materiality of certain underlying objective facts for purposes of pre-trial dismissal, "...requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and those assessments are peculiarly ones for the trier of fact."[17]

The Second Circuit ignored the principle established by this Court in *Northway* (and extended to Section 10b-5 claims in *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988)), when it harshly resolved all inferences that could be drawn from the facts presented against the Petitioner, and held that as a matter of law, the Petitioner was on inquiry notice of the aggregate unsuitability of her investments when she received her prospectuses.

Ignoring that fundamental principle when making an inquiry notice determination creates the following paradox. An investor, who, for the purpose of Section 10(b) and Rule 10b-5, can substantively prove reasonable reliance to a trier of fact (an element

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[17] *TSC Industries, Inc. v. Northway,* 425 U.S. 438 at 450 (1976).

of the cause of action), may be precluded from bringing her claim because she fails to meet the more rigid threshold standard of "inquiry notice" as a matter of law. If an investor is on inquiry notice, then it only makes sense to rule that as a matter of law, there cannot have been reasonable reliance. The effect of this paradox is to eviscerate the protections afforded investors in the 1934 Act.

This paradox is even more apparent in Rule 10b-5(b) unsuitability claims, which by their very nature, are often targeted to the sellers of securities and not the issuers. A reasonable reliance determination for those unsuitability cases includes an evaluation of a variety of factors, unique to each case, including the existence of fiduciary relationships, and the sophistication and experience of the investor in financial and securities matters.[18] An examination of the same factors is equally important in determining the threshold issue of inquiry notice. Although the Second Circuit has philosophically accepted that it must evaluate these subjective factors, it has nevertheless failed to do so, opting instead to dismiss these cases, including the one now before this Court, on summary judgment motions and motions to dismiss.[19]

The result of the failure to apply the *Northway* principle to the determination of inquiry notice is to turn a claim under Section 10(b) of the 1934 Act into a clone of a Section 12(2) disclosure claim. That failure, in essence, allows fraud to thrive in the securities industry, so long as investors are buried by the requisite voluminous disclosures required by federal law.

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[18] *Brown v. E.F. Hutton*, 991 F.2d 1020, 1022 (2d Cir. 1992).

[19] *Id.* at 1033; *See* Mohr, *Caveat Emptor Resurfaces in Securities Rulings*, RICO Law Report, Vol 18 No. 6 (December 1993).

That result is also contrary to the well-stated principles enunciated by this Court.[20] As Justice Marshall pointed out in *Basic, Inc. v. Levinson*, 485 U.S. at 234, "We have recognized time and again, [that] a 'fundamental purpose of the various Securities Acts, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus achieve a high standard of business ethics in the securities industry.' "

Although *Northway* and *Basic* both spoke to the issue of "reasonable reliance," in order to avoid the paradox discussed above, the analysis should be equally applicable to the evaluation of what constitutes inquiry notice for the purpose of triggering the one-year statute of limitations contained in Section 9(e) of the 1934 Act.

B. The Second Circuit Erred in Failing to Give Full Effect to Rule 10b-5 When it Determined that Petitioner Was On Inquiry Notice of Her Unsuitability Claim Upon Receipt of Prospectuses

The Second Circuit's ruling in the instant case is also contrary to the express language contained in Section 10(b) and Rule 10b-5 of the 1934 Act. Rule 10b-5 provides several bases for recovery under Section 10(b) of the 1934 Act, any one of which is sufficient to establish a cause of action for securities fraud.[21]

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[20] *S.E.C. v. Capital Gains Bureau*, 375 U.S. 180 at 186 (1963).

[21] *Affiliated Ute Citizens*, 406 U.S. 128, 152-154 (1972); *Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 917 (6th Cir. 1991), *citing Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 475-76.

The Second Circuit has long recognized "unsuitability" as a distinct subset of Section 10(b) claims.[22] Although it recently reaffirmed "unsuitability" as a basis for recovery in *Brown v. E.F. Hutton*, the Second Circuit has mistakenly blended Rule 10b-5's alternative theories of recovery into one cause of action,[23] ignoring the independent viability of causes of action brought pursuant to subparagraphs (a), (b) and (c) of Rule 10b-5.

This is clearly a wrong interpretation of the Rule. Rule 10b-5(b) deals strictly with omissions or misstatements of material fact. Rule 10b-5(a) makes it unlawful to "employ any device, scheme, or artifice to defraud," and Rule 10b-5(c) makes it unlawful to "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

That mistake was carried forward by the Second Circuit in the matter now before this Court. The Second Circuit held that "[i]ssuers cannot be expected to anticipate in their prospectuses or other offering papers the financial needs of every potential investor, the investment alternatives before each potential investor, and the risk averseness of each potential investor." (A-12).

Although an unsuitability claim can indeed be analyzed as one involving the misstatement or omission of a material fact, in accord with Rule 10b-5(b), it may also be considered "fraud by conduct," which is prohibited by Rule 10b-5(a) and (c), and is analogous to a "churning" claim. Under the second analysis, reliance

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[22] *Clark v. John Lamula Inv., Inc.*, 583 F.2d 594 (2d Cir. 1978) (In that case, the Court recognized that the plaintiff brought two 10b-5 claims; the first, recommending unsuitable investments, and the second, omitting to state a material fact. *Id.* at 600 n. 6 unsuitability claim.

[23] *Brown* 991 F.2d at 1031; *Luce v. Edelstein*, 802 F.2d 49, 51 (2d Cir. 1986).

is not an element.[24] Instead, a plaintiff must prove a recommendation of unsuitable securities and scienter on the part of the defendant.[25]

The petitioner's aggregate unsuitability claim was alternatively pleaded under both theories.[26] Since material misstatements or omissions are therefore not a necessary element of petitioner's aggregate unsuitability claim, her mere receipt of prospectuses could not, as a matter of law, have put her on inquiry notice.

If allowed to stand, the decision below will have a direct and substantial impact on how effective federal securities laws can be in stamping out common fraudulent practices in the securities industry (such as encouraging and allowing agents to sell unsuitable securities to investors), and will leave ordinary investors, such as the Petitioner, as victims in its wake. The decision below, in effect, renders void legislatively enacted protections, and thus undermines both the express language and clear intent of Section 10(b) and Rule 10b-5 of the 1934 Act, and should be overturned.

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[24] *Affiliated Ute Citizens*, 406 U.S. at 153-154.

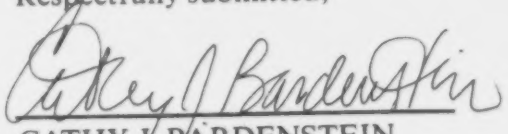
[25] *Clark v. John Lamula Investors, Inc.*, 583 F.2d 594, 599-600 (2d Cir. 1978); *O'Connor v. R.F. Lafferty & Co.*, 965 F.2d 893, 898 (10th Cir. 1992).

[26] *Hishon v. King & Spaulding*, 476 U.S. 69, 73 (1984) held that if a plaintiff would be entitled to relief under any set of facts, then a motion to dismiss cannot be granted.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should issue to review the judgment of the Court of Appeals for the Second Circuit.

Respectfully submitted,



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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 299—August Term, 1993

(Argued: September 20, 1993

Decided: December 14, 1993)

Docket No. 93-7064

MARY E. DODDS,

Plaintiff-Appellant,

—v.—

CIGNA SECURITIES, INCORPORATED, CIGNA INDIVIDUAL FINANCIAL SERVICES COMPANY, INCORPORATED, CONNECTICUT GENERAL LIFE INSURANCE CO., CIGNA CORPORATION; and MARTIN F. PALUMBOS,

Defendants-Appellees.

Before:

KEARSE and WINTER, *Circuit Judges*, and POLLACK, *Senior District Judge.**

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* The Honorable Milton Pollack, Senior United States District Judge for the Southern District of New York, sitting by designation.

Appeal from a decision of the United States District Court for the Western District of New York (David G. Larimer, *Judge*) holding that plaintiff-appellant Mary E. Dodds' federal securities claims were time-barred and dismissing her state law claims. Affirmed.

CATHY J. BARDENSTEIN, Rochester, New York (Gallo & Iacovangelo, Rochester, New York, of counsel), *for Plaintiff-Appellant.*

GLENN T. MARROW, Rochester, New York (Carolyn G. Nussbaum, Nixon, Hargrave, Devans & Doyle, Rochester, New York, of counsel), *for Defendants-Appellees.*

WINTER, *Circuit Judge*:

Mary E. Dodds appeals from Judge Larimer's dismissal of her amended complaint, holding as a matter of law that Dodds' federal securities claims were time-barred. *Dodds v. Cigna Securities, Inc.*, No. 92-CV-6053L (W.D.N.Y. Dec. 15, 1992). The district court also dismissed Dodds' pendent state law claims. We hold that when an investor is provided prospectuses that disclose that certain investments are risky and illiquid, she is on notice for purposes of triggering the statute of limitations that several such investments might be inappropriate in a conservative portfolio. We therefore affirm.

BACKGROUND

The amended complaint alleged as follows. On February 20, 1990, Dodds, a forty-five-year-old woman with a tenth-grade education and four school-aged daughters, was widowed. She learned that her husband had left her their home, a few personal assets, and approximately $445,000 in death and retirement benefits from his employer, including the proceeds of a savings and investment plan account, an individual retirement account, a life insurance policy, and checking and savings accounts. Before her husband's death, Dodds had no involvement in the family's financial affairs or investment decisions other than receiving an allowance for maintaining the household.

Dodds first met with defendant-appellee Martin F. Palumbos, an employee and/or agent of the appellee corporations, in March 1990. During March and April of 1990, Palumbos met with Dodds at her home on six occasions. During these meetings Dodds told Palumbos that she was wary of financial risk and sought to pursue a "conservative investment strategy" in order to allow her to support her family and provide her daughters with a college education.

On April 1, 1990, Palumbos left Dodds a large portfolio containing prospectuses, marketing materials, and other information on the securities and insurance products that he recommended. In addition, he left a fifteen-page report entitled "Financial Planning Considerations for Mary Dodds," which broadly outlined Dodds' financial situation and the sort of investment portfolio Palumbos recommended. Included were several limited partnerships that ultimately gave rise to the present action. Palumbos

told Dodds that he would return in two weeks to discuss her investments.

On April 18, 1990, Palumbos and Dodds met again. At that meeting, Dodds told Palumbos that she had attempted to but had not read the prospectuses because "they looked like greek" to her and she could not understand them. Dodds also told Palumbos that she had given the materials to her brother-in-law, Daniel LaLonde, but that he had not had time to review them. Palumbos discussed the securities he had recommended and assured her that the investments were suitable. The discussion never touched upon the risks of investing in limited partnerships generally or on the risks associated with investing in the specific limited partnerships Palumbos recommended. At the meeting, Dodds signed over the funds she had received from her husband's savings and investment plan account and his I.R.A. On April 24, 1990, Palumbos returned to Dodds' home. At this meeting, Dodds signed the checks necessary to invest the proceeds of her husband's life insurance policy in the securities and insurance products that Palumbos had recommended.

Paragraph 37 of the amended complaint reads as follows:

> 37. On both April 18, 1990 and April 24, 1990, defendant Palumbos arrived at the plaintiff's home with a number of documents he wanted the plaintiff to sign, stating that the documents were purchase orders for the various securities being purchased. Plaintiff had never seen these documents prior to signing them. The documents were placed in a stack for the plaintiff to sign, and the defendant Palumbos induced the plaintiff to sign the documents without either reviewing them with her, or giving her an

> opportunity to read them. Additionally, Palumbos induced plaintiff to sign the disclosure statements and subscription agreements without dating them because of 'timing considerations'. . . .

After Dodds had signed the documents, Palumbos left the yellow duplicate copies of the purchase orders but took the originals of the purchase orders and all the other documents that were signed with him. In June 1990, Palumbos returned, sorted the documentation on Dodds' investments, and disposed of the yellow copies of the purchase orders, saying they were "useless."

Dodds took no further action regarding her finances until February 7, 1991, when she met with an accountant to complete her 1990 tax returns. The accountant told her that the investments in the limited partnerships were unsuitable for her. Soon thereafter, Dodds contacted Palumbos and arranged a meeting with him, another financial planner, and her brother-in-law LaLonde.

Dodds contacted an attorney in April 1991. From April through November, Dodds' attorney sought to help her by corresponding with appellee Connecticut General Life Insurance Company. In November, the firm stopped representing Dodds. Dodds hired her present counsel in December 1991 and the instant suit was filed in the Western District on February 4, 1992. Dodds filed an amended complaint on April 30, 1992.

Dodds' amended complaint sets forth eleven claims. Counts one through four allege violations of Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (1988) (the " '33 Act"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988) (the " '34 Act"), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, Section 15 of the '33 Act, 15 U.S.C. § 77o (1988), and Section 20 of the

'34 Act, 15 U.S.C. § 78t (1988), by the Cigna Companies and Palumbos. Counts five through eleven of Dodds' amended complaint are pendent state law claims for common law fraud, breach of fiduciary duty, negligent misrepresentation, and violation of Section 349 of the General Business Law of New York.

Dodds' federal claims are based on the sale of interests in five limited partnerships that Dodds purchased at the April 18 and 24 meetings. These investments were as follows: (A) 230 units of Technology Funding Secured Investors III limited partnership for $23,000, (B) 32 units of Berry and Boyle Development Partners III limited partnership for $16,000, (C) 800 units of Krupp Cash Plus V limited partnership for $16,000, (D) 500 units of PLM Equipment Growth Fund V limited partnership for $10,000, and (E) 400 units of Net 2 limited partnership for $40,000. All the investments except the last were to be held in Dodds' I.R.A. Dodds' total investment in these five limited partnerships was $105,000.

The gravamen of Dodds' federal claims is that Palumbos and the Cigna Companies made material false statements and omissions inducing her to invest in securities—the five limited partnerships—that were unsuitable for her because they were too risky and illiquid.

Judge Larimer dismissed Dodds' federal securities claims on the grounds that she had not brought suit within the statute of limitations period. *Dodds v. Cigna Securities, Inc.*, No. 92-CV-6053L, slip op. at 19 (W.D.N.Y. Dec. 15, 1992). The court then dismissed Dodds' state law claims without prejudice.

DISCUSSION

We begin by defining what is not in dispute. Appellant filed this action more than one year after the date on which she made the investments and suffered the alleged losses. It is also uncontested that she did file her suit within one year of when her accountant told her of the investments' unsuitability. All parties also agree that the applicable statute of limitations for Dodds' federal securities claims is the one-year-after-discovery/no-later-than-three-years scheme established in *Ceres Partners v. GEL Associates*, 918 F.2d 349 (2d Cir. 1990), and *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773 (1991).

Appellant challenges the district court's decision on three grounds. First, she argues that the district court erred in not measuring the timeliness of her federal claims from the date on which her accountant told her of the unsuitability of her investments. Second, she argues that the court erred in ruling that there was no fraudulent concealment that would have tolled the statute of limitations. Third, appellant claims that the Supreme Court's decision in *Lampf*, and the language of Section 9(e) of the '34 Act, 15 U.S.C. § 78i(e) (1988), require that the statute of limitations in Section 10(b) of the '34 Act cases run from the time of actual rather than constructive notice. We address these contentions in turn.

I. *Triggering the Statutory Period*

Appellant's claims under Sections 11, 12, and 15 of the '33 Act are governed by the statute of limitations contained in Section 13 of the '33 Act. 15 U.S.C. § 77m

(1988).[1] Dodds' claims under Sections 10(b), 9, and 20 of the '34 Act are subject to the statute of limitations in Section 9(e) of the '34 Act.[2] Broadly speaking, the statutory periods for claims under either of these provisions begin to run when the claim accrued or upon discovery of the facts constituting the alleged fraud. Discovery, however, includes constructive and inquiry notice as well as actual notice.

A plaintiff in a federal securities case will be deemed to have discovered fraud for purposes of triggering the statute of limitations when a reasonable investor of ordinary intelligence would have discovered the existence of the fraud. *Armstrong v. McAlpin*, 699 F.2d 79, 88 (2d Cir. 1983); *Robertson v. Seidman & Seidman*, 609 F.2d 583, 587 (2d Cir. 1979); *Arneil v. Ramsey*, 550 F.2d 774, 780 (2d Cir. 1977). As we said in *Armstrong*, "The test as to when fraud should with reasonable diligence have been discovered is an objective one. '[T]he means of knowledge are the same thing in effect as knowledge itself.' "

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[1] Section 13 of the '33 Act reads in part:

> No action shall be maintained to enforce any liability created under [Section 11 or Section 12(2)] unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence
>
> . . . .

15 U.S.C. § 77m (1988). Since Section 15 merely creates a derivative liability for violations of Sections 11 and 12, Section 13 applies to it as well. *Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981).

[2] Section 9(e) of the '34 Act reads in part:

> No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

15 U.S.C. § 78i(e) (1988). Because Section 20 merely creates a derivative liability for violations of other sections of the Act, claims under Section 20 are governed by the limitations periods for those other sections. *Herm*, 663 F.2d at 679.

Armstrong, 699 F.2d at 88 (citation omitted) (quoting *Wood v. Carpenter*, 101 U.S. 135, 143 (1879)). Moreover, when the circumstances would suggest to an investor of ordinary intelligence the probability that she has been defrauded, a duty of inquiry arises, and knowledge will be imputed to the investor who does not make such an inquiry. *Armstrong*, 699 F.2d at 88. Such circumstances are often analogized to "storm warnings." *See Cook v. Avien, Inc.*, 573 F.2d 685, 697 (1st Cir. 1978).

The doctrine of equitable tolling is similarly limited. Equitable tolling will stay the running of the statute of limitations only so long as the plaintiff has "exercised reasonable care and diligence in seeking to learn the facts which would disclose fraud." *Arneil*, 550 F.2d at 781 (quoting *Morgan v. Koch*, 419 F.2d 993, 997 (7th Cir. 1969)).

Appellant acknowledges that the standard is an objective one. She argues, however, that whether an investor of ordinary intelligence would be on inquiry notice in the circumstances described in the complaint is for a trier to determine and may not be resolved against her as a matter of law. We disagree.

The gist of appellant's amended complaint is that the appellees, in order to make higher commissions, induced her to invest in limited partnerships that were unsuitable for her because of their risk and illiquidity. However, the commissions, the risk, and the illiquidity of investments in the limited partnerships were clearly disclosed in the prospectuses. For example, the prospectus for the Technology Funding Secured Investors III limited partnership has a clearly marked seven-page section entitled "Risk Factors." Within this section, under the sub-section "Lack of Liquidity," the prospectus states, "There is no current

public or secondary market for the [limited partnership] Units nor is one likely to develop." The section is strewn with warnings about the risks inherent in the limited partnership's intended business—venture capital. Finally, a separate sub-section labelled "Commissions and Other Payments to Participating Broker-Dealers" clearly explains the commissions the broker-dealer receives upon sales of units in the limited partnership.

The prospectus for the Berry and Boyle Development Partners III limited partnership is equally clear. The prospectus on the first page states in bold, all-capital, oversized letters set off from the rest of the text, "**THE SECURITIES OFFERED HEREBY INVOLVE A HIGH DEGREE OF RISK**." Immediately below this warning appears a table with the selling commissions depicted. The second page, under a description of "Risk Factors," states, "No public market for the [limited partnership] Units exists or is expected to develop. Accordingly, the Units should be purchased only as a long-term investment, since investors may not be able to liquidate their investment in the event of emergency or for any other reason."

These warnings, and similar ones in the other prospectuses, were sufficient to put a reasonable investor of ordinary intelligence on notice of the commissions, the risk, and the illiquidity of these investments. Acknowledging the existence of these warnings, appellant emphasizes the length of the prospectuses. Yet despite their length, most of the prospectuses are indexed, or at least have clear section headings on risk, transferability, and commissions. In any event, a failure to read the prospectuses is not excused because of the documents' length. *See Armstrong*, 699 F.2d at 88 ("the means of knowledge are the same thing in effect as knowledge itself"); *DeBruyne v.*

Equitable Life Assur. Soc. of the U.S., 920 F.2d 457, 466 n.18 (7th Cir. 1990) (plaintiff "cannot avoid the statute of limitations by possessing, but failing to read, the documents that would put [her] on inquiry notice").

Moreover, appellant was on constructive notice of the pertinent matters as a result of the one-page disclosure forms she signed before investing in each of the limited partnerships. These documents explicitly warned of the illiquidity of the investments and the commissions to be received. Most of the forms prominently state near the top: "I fully understand the illiquid nature of an investment in [the limited partnership] and that no secondary market is likely to exist for limited partnership units."

Appellant advances two arguments to avert the conclusion that the prospectuses and disclosure forms constituted constructive notice. First, she distinguishes the present case from a number of decisions in which investors were held to be on constructive notice of fraud after they received numerous account statements and quarterly financial reports that disclosed the adverse information of which they later complained. *DeBruyne*; *Armstrong*; *Koke v. Stifel, Nicolaus & Co.*, 620 F.2d 1340 (8th Cir. 1980); *Arneil*. It is correct that the present case differs in this regard, but the difference does not affect the outcome. In this case, the matters of which Dodds complains were clearly disclosed in a manner sufficient to put a reasonable investor on constructive notice that she had not been sold investments of the type she sought. In fact, because the issue is the very suitability of the investments in the limited partnerships, account statements and quarterly financial reports would not have substantially enhanced the relevant information available. The riskiest and most illiquid investment may perform well or may

perform poorly. Actual performance will shed little light on its *ex ante* suitability for a given investor.

Second, appellant claims that she was defrauded by being sold a portfolio of securities that, when considered in the aggregate, were unsuitable for her. According to her theory, individual prospectuses do not serve to put an investor on notice of aggregate unsuitability because the challenge is not to the suitability of the individual investments but to the suitability for her portfolio of multiple investments in limited partnerships. Specifically, she maintains that prospectuses are an insufficient warning as to the unsuitability of investing in multiple limited partnerships of the kind in question because an investor like her meets the minimum suitability standards contained in the individual prospectuses. She thus argues that a reasonable investor would not have concluded from the prospectuses that investments in multiple limited partnerships constituted an unsuitable portfolio for an investor in her situation. We disagree.

We have recognized unsuitability claims as a distinct subset of Section 10(b) claims. *See Brown v. E.F. Hutton Group, Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1993). However, a reasonable investor must be deemed to have some understanding of diversification and some independent view as to how much risk she is willing to undertake. Issuers cannot be expected to anticipate in their prospectuses or other offering papers the financial needs of every potential investor, the investment alternatives before each potential investor, and the risk averseness of each potential investor. Nor can a plaintiff rely on misleading oral statements to establish an unsuitability claim when the offering materials contradict the oral assurances. *See id.* Moreover, for statute of limitations purposes, the issue is not whether appellant was given inadequate information

about the advisability of investments in multiple limited partnerships but whether she had constructive notice of facts sufficient to create a duty to inquire further into that matter. An investor does not have to have notice of the entire fraud being perpetrated to be on inquiry notice. Appellant was constructively aware of the portion of her total portfolio that included investments described as risky and illiquid. That sufficed to raise a duty to inquire into whether they constituted too substantial a portion of her portfolio. Constructive knowledge that roughly a quarter of her assets was being invested in risky, illiquid ventures surely constituted at least a "storm warning[ ]" to a reasonable investor with conservative instincts sufficient to raise a duty to inquire further.

Moreover, the minimum suitability standards contained in the prospectuses were not otherwise misleading. In most of the prospectuses, the suitability standards are preceded by a statement such as the one in the Net 2 limited partnership prospectus: "The purchase of Limited Partnership Interests involves certain risks and, accordingly, is suitable only for persons or entities of adequate means having no need for liquidity in their investment." The suitability standards in no way suggested that the other warnings in the prospectuses of the risk and illiquidity of the investments should be ignored if the standards are met. Given these facts, the qualified minimum suitability standards in the prospectuses would not have beguiled a reasonable investor of ordinary intelligence into believing that investment of roughly a quarter of her assets in risky, illiquid vehicles was consistent with her conservative financial plan.[3] Appellant was thus on inquiry

[3] Finally, appellant's suggestion that the question of constructive notice is an improper subject for resolution as a matter of law is contradicted by a vast number of cases in this circuit resolving these issues at the pleading stage. *See In re Integrated Resources Real Estate Limited Part-*

notice when she made the investments in question, and her suit was filed more than one year after her claim accrued.

II. *Fraudulent Concealment*

Appellant also claims that the district court erred in ruling that there was no fraudulent concealment tolling the statute of limitations. If the defendants actively prevented Dodds from discovering the basis of her claim, then the statute would be tolled for the period of concealment. Appellant relies in particular on *McCoy v. Goldberg*, 748 F. Supp. 146, 158 (S.D.N.Y. 1990), in which the statute of limitations was tolled where an investment advisor "deterred plaintiff from examining the extensive offering documents."

Dodds bases her fraudulent concealment argument on several grounds. First, as noted above, Dodds alleges in her amended complaint that at the April 18 and 24 meetings, "the defendant Palumbos induced the plaintiff to sign the documents without either reviewing them with her, or giving her an opportunity to read them." Dodds also alleges that Palumbos returned to her home in June 1990 and threw away copies of the purchase orders she had signed. Finally, Dodds suggests that the fifteen-page report Palumbos prepared for her deceived her into not reading the prospectuses.

It is unclear whether the reference in paragraph 37 of the amended complaint to "the documents" is meant to include the disclosure forms, subscription agreements,

nerships Sec. Litig., 815 F. Supp. 620, 639 n.7 (S.D.N.Y. 1993) (citing cases). Where, as here, the facts needed for determination of when a reasonable investor of ordinary intelligence would have been aware of the existence of fraud can be gleaned from the complaint and papers such as the prospectuses and disclosure forms that are integral to the complaint, resolution of the issue on a motion to dismiss is appropriate.

and the purchase orders, or some combination of these three items. However, resolution of this ambiguity is not necessary. There is no allegation that defendants prevented or discouraged Dodds from reviewing the prospectuses that were provided to her several weeks before she invested in the limited partnerships. Because receipt of the prospectuses alone put Dodds on constructive notice of her claims, the allegations in question do not amount to fraudulent concealment. For the same reasons, Palumbos' alleged disposal of the purchase orders does not toll the statute.

Finally, the report does not in any way suggest that it could be a replacement for the prospectuses. In fact, the report does not purport to describe the limited partnership investments in any manner other than to list the investments in the "Growth" portion of a chart depicting Palumbos' suggested portfolio. Nor is there any allegation that Palumbos suggested Dodds read the report in lieu of the prospectuses.

III. *Lampf and Actual Notice*

Finally, Dodds contends that the Supreme Court's decision in *Lampf* requires that the statute of limitations in Section 10(b) cases run from the time of actual rather than constructive notice. Dodds argues that the adoption of Section 9(e) as the governing standard in *Lampf* requires that the statute of limitations in Section 10(b) cases run only from the moment of actual notice.

Dodds acknowledges, however, that our cases have held the one-year statute of limitations announced in *Ceres Partners* to run from the time of inquiry or constructive notice. *See, e.g., Kahn v. Kohlberg, Kravis, Roberts & Co.*, 970 F.2d 1030, 1042 (2d Cir.), *cert. denied*, 113 S.

Ct. 494 (1992); *Henley v. Slone*, 961 F.2d 23, 24 (2d Cir. 1992). Dodds also acknowledges that we have held in a decision subsequent to the Supreme Court's decision in *Lampf* that the Section 10(b) statutory periods adopted in *Ceres Partners* and later confirmed in *Lampf* include the concepts of constructive and inquiry notice. *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993). In *Menowitz*, we specifically rejected the argument that the Supreme Court's decision in *Lampf* requires that we measure Section 10(b) claims from the time of actual notice. *Menowitz*, 991 F.2d at 41-42. Only an *in banc* court or an intervening Supreme Court decision can overrule these decisions. *Kremer v. Chemical Construction Corp.*, 623 F.2d 786, 788 (2d Cir. 1980), *aff'd*, 456 U.S. 461 (1982).

Because we have concluded that the district court correctly dismissed Dodds' federal claims as time-barred, we need not address her request to have her supplemental state law claims reinstated or her request for leave to replead.

Affirmed.

MANDATE

WDNY
92-cv-6053
Larimer

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

———•———

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 14th day of December, one thousand nine hundred and ninety-three.

Present: HON. AMALYA L. KEARSE,
HON. RALPH K. WINTER,
Circuit Judges.
HON. MILTON POLLACK,
Senior District Judge.*

United States Court of Appeals
Filed
DEC 14 1993
GEORGE LANGE III, CLERK
SECOND CIRCUIT

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U.S. DISTRICT COURT
W.D.N.Y.-BUFFALO

MARY E. DODDS,

Plaintiff-Appellant,

-v.-

Docket No. 93-7064

CIGNA SECURITIES, INCORPORATED, CIGNA INDIVIDUAL FINANCIAL SERVICES COMPANY, INCORPORATED, CONNECTICUT GENERAL LIFE INSURANCE CO., CIGNA CORPORATION; and MARTIN F. PALUMBOS,

Defendants-Appellees.

Appeal from the United States District Court for the Western District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Western District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the appeal from the order of said district court be and it hereby is affirmed in accordance with the opinion of this Court with costs to be taxed against the appellant.

GEORGE LANGE III, Clerk
By: s/Edward J. Guardaro,
Edward J. Guardaro,
Staff Attorney

A TRUE COPY
GEORGE LANGE III, CLERK
By s/Carolyn Clark Cough
Chief Deputy Clerk

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* The Honorable Milton Pollack, Senior United States District Judge for the Southern District of New York, sitting by designation.

ISSUED AS MANDATE. 1-6-94

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

MARY E. DODDS,

Plaintiff,

-vs- 92-CV-6053L

CIGNA SECURITIES, INC., et al.,

Defendants.

Take notice of an Order of which the within is a copy, duly granted in the within entitled action on the 15th day of December, 1992 and entered in the office of the Clerk of the United States District Court, Western District of New York, on the 15th day of December, 1992.

Dated: Rochester, New York
December 16, 1992

RODNEY C. EARLY, Clerk
U.S. District Court
Western District of New York
282 U.S. Courthouse
Rochester, New York 14614

TO: Carolyn Nussbaum, Esq.
Cathy Bardenstein, Esq.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

MARY E. DODDS,

Plaintiff,

v.

CIGNA SECURITIES, INC., CIGNA INDIVIDUAL FINANCIAL SERVICES COMPANY, INC., CONNECTICUT GENERAL LIFE INSURANCE COMPANY, CIGNA CORPORATION, and MARTIN F. PALUMBOS,

Defendants.

DECISION AND ORDER
92-CV-6053L

Plaintiff Mary E. Dodds commenced this securities fraud action seeking recision and damages against her former investment advisor, Martin Palumbos ("Palumbos"), and the companies he represented -- Cigna Securities, Inc., Cigna Individual Financial Services Company, Inc., Connecticut General Life Insurance Company, and Cigna Corporation (collectively, the "Cigna Companies"). This action revolves around plaintiff's investment in five limited partnerships -- Technology Funding Secured Investors III ("TFSI"), Berry and Boyle Development Partners III (Barry and Boyle"), Krupp Cash Plus V ("Krupp"), PLM Equipment Growth Fund V ("PLM"), and Net 2 -- and her purchase of a single premium annuity policy and a whole life insurance policy in the spring of 1990. Plaintiff alleges that Palumbos and the Cigna Companies recommended that she invest in these limited partnerships and purchase the annuity and life insurance policies despite knowing that they were unsuitable for her financial needs, in that the investments were, *inter alia,* too risky, too expensive, and not liquid enough.

In her amended complaint, plaintiff alleges that Palumbos and the Cigna Companies violated federal securities laws, including

section 12(2) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. §§ 771(2) (Count one), section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78j(b), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 (Count three), and that the Cigna Companies are liable as controlling persons under section 15 of the 1933 Act, 15 U.S.C. § 77o (Count two), and section 20 of the 1934 Act, 15 U.S.C. § 78t (Count four), or, alternatively, as aiders and abettors. Plaintiff further alleges several pendant state law claims against Palumbos and the Cigna Companies, including breach of fiduciary duty, common law fraud, negligent misrepresentation, and a violation of § 349 of the General Business Law of the State of New York (Counts five-eleven).

Pending before me now are defendants' motion to dismiss the amended complaint and plaintiff's motion for leave to replead if the amended complaint is dismissed. Defendants contend that plaintiff's federal securities claims should be dismissed because they are untimely under the applicable one-year/three-year limitations period, or, alternatively, because they fail to state a claim upon which relief may be granted, Fed.R.Civ.P. 12(b)(6), or because they fail to plead fraud with sufficient particularity, Fed.R.Civ.P. 9(b). Defendants further contend that if the federal claims are dismissed, the pendent state law claims should be dismissed for lack of jurisdiction.

For the reasons discussed below, defendants' motion to dismiss is granted, and plaintiff's motion for leave to file a second amended complaint is denied.

BACKGROUND

The facts alleged in the amended complaint, which must be accepted as true for purposes of this motion, are as follows. On April 18 and 24, 1990, plaintiff purchased shares and units in various securities recommended to her by Martin Palumbos, includ-

ing 230 units of TFSI for $23,000; 32 units of Berry and Boyle for $16,000; 800 units of Krupp for $16,000; 500 units of PLM for $10,000; and 400 units of Net 2 for $40,000.[1] Plaintiff also purchased a $25,000 single premium annuity policy, and a $250,000 whole life insurance policy with a premium of $36,700.

Plaintiff, an inexperienced first-time investor, was looking to invest approximately $445,000[2] in insurance and retirement benefits that she had received after her husband's death in February, 1990. She sought to invest this money in conservative investments that could generate enough income for her living expenses and for her to pay for the education of her four daughters.

Before making these investments, plaintiff met with Palumbos on several occasions. Plaintiff and Palumbos met for the first time on March 14, 1990. At this meeting, Palumbos told plaintiff that he was a representative of Cigna and that he had helped a number of Eastman Kodak employees with their financial planning. Plaintiff's husband was employed at Kodak before his death. Palumbos told plaintiff that after assessing her financial situation he would consult with other Cigna representatives and

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[1] Plaintiff also invested in, *inter alia*, an unknown number of units in Textainer limited partnership for $40,000; 3,906 shares of Oppenheimer Strategic Income fund for $20,000; 1,638 shares of Oppenheimer New York Tax Exempt Fund for $20,000; 1,990 shares of Cigna Government Securities Fund for $20,000; 1,573 shares of Cigna Utilities Fund for $20,000; 2,641 shares of Cigna Income Fund for $20,000; 2,335 shares of Cigna High Yield Fund for $20,000; 1,925 shares of Washington Mutual Investors Fund, Inc. for $30,000; 1,837 shares of Investment Company of America for $30,000; and 1,333 shares of Growth Fund of America, Inc. for $30,000. Plaintiff does not challenge the appropriateness of these investments.

[2] The benefits consisted of approximately $165,000 from her husband's Eastman Kodak Savings and Investment Plan ("SIP") and individual retirement account ("IRA"), $275,000 from his life insurance policy, $5,000 in checking and savings accounts, and a right to receive monthly payments of $315 from his retirement annuity, which was to commence when he turned 55 years of age.

together they would develop an investment plan that would suit her needs. He also told plaintiff that rather than charging her a fee he would be paid through commissions on the investments she made.

Palumbos and plaintiff met again on April 1, 1990. At this meeting, Palumbos gave plaintiff a number of prospectuses and marketing materials that detailed the securities and insurance products that he was recommending. Included with these materials were the prospectuses on TFSI, Berry and Boyle, Krupp, PLM, and Net 2. Palumbos told plaintiff that he would return in two weeks to complete the transactions.

Palumbos returned on April 18, 1990. He asked plaintiff whether she had any questions concerning the investments he had recommended. Plaintiff responded that she had not read the prospectuses because "they looked like Greek" to her. Palumbos assured her that the investments were suitable. Plaintiff, consequently, authorized Palumbos to invest the funds she had received from her husband's SIP and IRA accounts. Plaintiff then signed the required purchase orders, disclosure statements, and subscription agreements. However, plaintiff claims that she did not read any of these documents, and Palumbos did not review them with her. At Palumbos' direction, she did not date these forms when she signed them. Palumbos left a copy of the purchase agreement with plaintiff, but took the originals, the disclosure statements, and the subscription agreements with him.

Palumbos met with plaintiff again on April 24, 1990. At this meeting, plaintiff authorized Palumbos to invest the money she had received from her husband's life insurance policy. Once again, plaintiff signed the required purchase orders, disclosure statements, and subscription agreements, but again failed to read any of the documents. Once again, she did not date the purchase orders. As he did before, Palumbos left a copy of the purchase

agreement with plaintiff, but took the other signed documents with him.

Palumbos and plaintiff met again in early June 1990. At this meeting, Palumbos sorted the documentation concerning plaintiff's investments and disposed of the copies of the purchase agreements. After this meeting, plaintiff did not concern herself with her investments until February 7, 1991 when she met with her accountant, who told her that, in his opinion, the investments were unsuitable for her financial and personal situation. Plaintiff subsequently commenced this action on February 4, 1992, and filed an amended complaint on April 30, 1992.

In her amended complaint, plaintiff alleges that Palumbos made fraudulent statements and omissions, and induced her to invest in securities - the five limited partnerships - that were completely unsuitable for her needs because they were too risky, not liquid, and not intended for someone in her situation. Plaintiff contends that there is no public market in which she can sell her partnership units and that she has already lost $3,850 on her investment in the partnerships. She also alleges that Palumbos and the Cigna Companies induced her to invest in the partnerships to generate substantial commissions, contending that defendants earned $8,005 in commissions on her purchase of units in the five partnerships. Plaintiff also alleges that the annuity and insurance policy Palumbos induced her to buy were too expensive and reduced the amount of cash currently available to her. Thus, the claims raised by this action fall essentially into one category -- a claim for unsuitability, i.e. that defendants, despite knowing that the five limited partnerships, the annuity, and the life insurance policy were unsuitable investments for plaintiff, still recommended that she invest in them.

DISCUSSION

I. *Motion to Dismiss: The Legal Standard.*

Defendants move to dismiss under Rules 12(b)(6) and 9(b), Fed.R.Civ.P. On a motion to dismiss, the trial court's function "is merely to assess the legal feasibility of the complaint, not to assay the weight of the evidence which might be offered in support thereof." *Geisler v. Petrocelli*, 616 F.2d 636, 639 (2d Cir. 1980); *see Ricciuti v. N.Y.C. Transit Authority*, 941 F.2d 119, 124 (2d Cir. 1991). "[T]he issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). The Court should grant a motion to dismiss "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King and Spaulding*, 467 U.S. 69, 73 (1984).

Consideration of a motion to dismiss the complaint must focus on the allegations contained on the face of the complaint. *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 773 (2d Cir. 1991). Moreover, on a motion to dismiss, a district court must accept plaintiff's factual allegations as true. *Papasan v. Allain*, 478 U.S. 265, 283 (1986), and the allegations must be "construed favorably to the plaintiff." *LaBounty v. Adler*, 933 F.2d 121, 123 (2d Cir. 1991).

II. *Statute of Limitations*

The primary issue raised by this motion is whether plaintiff commenced this action within the applicable one-year/three-year limitations period. The amended complaint alleges that plaintiff purchased her units in the five limited partnerships on April 18 and 24, 1990, that she had received the prospectuses on the partnerships before making the investment, and that she signed the disclosure statements and subscription agreements

when she signed the purchase agreements. The prospectuses and disclosure statements warn of the risk involved in, and the illiquid nature of, the investment, and they set out the commission that would be earned on each investment. Yet, plaintiff did not commence this action until February 4, 1992, more than one year after she purchased the securities, and, more than one year after she received the prospectuses and signed the disclosure statements.

Claims brought under section 12(2) of the 1933 Act, section 10(b) of the 1934 Act, and rule 10b-5 are governed by a one-year/three-year limitations period. 15 U.S.C. § 77m (1933 Act);[3] *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 111 S.Ct. 2773 (1991).[4]

Defendants contend that plaintiff's claims are time-barred under the one-year limitations period, because she commenced this action more than one-year after she reasonably could have discovered the alleged fraud. Plaintiff, defendants argue, possessed enough information, and could have, through the exercise of reasonable diligence, discovered the fraud when she received the prospectuses and signed the disclosure statements.

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[3] Section 13 of the 1993 Act, 15 U.S.C. § 77m, provides:

> No action shall be maintained to enforce any liability created under section 77k or 771(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 771(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 771(1) of this title more than three years after the security was bona fide offered to the public, or under section 771(2) of this title more than three years after the sale.

[4] "Litigation instituted pursuant to § 10(b) and rule 10b-5 therefore must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf,* 111 S.Ct. at 2782.

In response, plaintiff contends that because she is a naive and innocent investor, mere receipt of the prospectuses did not cause the limitations period to accrue. "Discovery takes place at different times," she argues, "depending upon the specific nature, sophistication and characteristics of the investor." Plaintiff's Memorandum of Law in Opposition to Motion to Dismiss Amended Complaint ("Plaintiff's Mem.) at 6. In addition, relying principally on *Werner v. Satterlee, Stephens, Burke & Burke*, 797 F.Supp. 1196, 1204 (S.D.N.Y. 1992) and *Hauman v. Illinois Power Company,* Fed.Sec.L.Rep. (CCH) 9 96,882, at 93,606 (C.D.Ill. August 29, 1991), plaintiff contends that an investor is not required to exercise reasonable diligence to uncover fraudulent conduct under section 10(b) and rule 10b-5, because the one-year limitations period prescribed by *Lampf* accrues only upon *actual* discovery of the fraud.

I am not persuaded by plaintiff's arguments. Plaintiff could have, by the exercise of reasonable diligence, discovered the alleged fraud more than one year before she commenced this action. Consequently, her claims under the 1933 Act and the 1934 Act are time-barred under the one-year limitations period.

"The test as to when fraud should with reasonable diligence have been discovered is an objective one." *Armstrong v. McAlpin,* 699 F.2d 79, 88 (2d Cir. 1983). " 'Where the circumstances are such as to suggest to a person of ordinary intelligence the probability that he has been defrauded, a duty of inquiry arises, and if he omits that inquiry when it would have developed the truth, and shuts his eyes to the facts which call for investigation, knowledge of the fraud will be imputed to him.' " *Id.* (quoting *Higgins v. Crouse,* 147 N.Y. 411, 416 (1895)); *Arneil v. Ramsey,* 550 F.2d 774, 780 (2d Cir. 1977). This is true whether the claim is one under section 12(2) of the 1933 Act, section 10(b) of the 1934 Act, or rule 10b-5. *See Anixter v. Home-Stake Production Co.,* 939 F.2d 1420, 1441-42 (10th Cir. 1991) ("Anixter I"),

vacated on other grounds and remanded sub nom. Dennler v. Trippet, 112 S.Ct. 1658 (1992); *accord Mittendorf v. J.R. Williston & Beane Inc.*, 372 F.Supp. 821, 832 (S.D.N.Y. 1974).

Thus, the relevant inquiry here is when was plaintiff in possession of sufficient information to place her on notice, whether actual notice or inquiry, that she may have been defrauded. *See, e.g. Anixter*, 939 F.2d at 1437 ("Notice is the key to our analysis, and merely 'inquiry notice' will do."); *DeBruyne v. Equitable Life Assur. Soc. of the U.S.*, 920 F.2d 457, 466 (7th Cir. 1990) ("the one year limitations period begins to run even when a plaintiff is placed on 'inquiry notice' of possible misrepresentation"); *Davidson v. Wilson*, 973 F.2d 1391, 1402 (8th Cir. 1992) (limitations period begins to run even when plaintiff is only on inquiry notice).

A review of the amended complaint reveals that plaintiff, by the exercise of reasonable diligence, should have been on inquiry notice of the alleged fraud when she received the prospectuses on the five limited partnerships, and signed the subscription agreements and disclosure statements. "Inquiry notice is triggered by evidence of the possibility of fraud, not full exposition of the scam itself." *Kennedy v. Josephthal & Co., Inc.*, 814 F.2d 798, 802 (1st Cir. 1987). "[T]he statute runs from the time at which plaintiff should have discovered the general fraudulent scheme." *Arneil*, 550 F.2d at 780 (quoting *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402, 410 (2d Cir. 1975)). It does not await her "leisurely discovery of the full details of the alleged scheme."

The offering materials explain much of the information that plaintiff contends Palumbos neglected to tell her; they set out the commissions that would be earned from each investment, Amended Complaint at ¶ 40(H), and the relevant risk factors, suitability requirements, and liquidity of each limited partner-

ship.[5] For example, the TFSI prospectus states on page three that "[i]nvestment in the Partnership is suitable only for investors of adequate financial means who have no need for liquidity with respect to this investment. Palumbos Aff., Ex. A. On page eight, the prospectus warns that "[p]rospective investors should carefully consider the risks that are described below ...," *id.* and it later describes the various risks.

Additionally, the PLM prospectus states on its cover that "[t]here is no public market for the units and none is expected to develop." Palumbos Aff., Ex. E. It goes on to warn that "[t]his offering involves certain risk factors and substantial fees to the general partner and affiliates."

The remaining prospectuses also warn, to varying degrees, of the risk involved in the investment, the illiquid nature of the investment, and the lack of a public market for the units in the limited partnership.

These warnings were sufficient to place an investor of ordinary intelligence, such as plaintiff, on inquiry notice of the alleged fraud. *See Koke v. Stifel, Nicolaus & Co., Inc.*, 620 F.2d 1340, 1343-44 (8th Cir. 1980); *Kennedy*, 814 F.2d at 802-03. *Bur see Luksch v. Latham*, 675 F.Supp. 1198 (N.D.Cal. 1987). Plaintiff's claim that she did not read or understand the offering material is unavailing. Plaintiff "cannot avoid the statute of limitations by possessing, but failing to read, the documents that would put [her] on inquiry notice." *DeBruyne*, 920 F.2d at 466 n. 18. A plaintiff is not free to ignore pertinent documents even if she is not able to fully understand their meaning. *Koke*, 620 F.2d at

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[5] It is proper to examine such documents, which are integral to the complaint, on a motion to dismiss even if they are not attached as an exhibit to the complaint. *I. Meyer Pincus & Assoc. v. Oppenheimer & Co., Inc.*, 936 F.2d 759, 762 (2d Cir. 1991); *Kramer*, 937 F.2d at 773-74. The relevant documents are attached as exhibits to the Affidavit of Martin Palumbos ("Palumbos Aff."), and will be referenced accordingly.

1343-44 (even if plaintiff thought monthly account statements looked like "hieroglyphics," she was not free to ignore them). An investor is obligated to read the prospectus or other offering material or have someone explain it to her. *See Marlow v. Gold*, Fed.Sec.L.Rep. (CCH) ¶ 96,112, at 90634 (S.D.N.Y. June 6, 1991). By failing to read the offering material, an investor proceeds at her peril.

Moreover, plaintiff should have been alerted to the possibility of fraud when she signed the disclosure statements. The disclosure statements, in contrast to the long descriptions in the prospectuses, are short one-page outlines of the special risks involved in investing in the partnerships. For example, the TFSI disclosure form states: "I fully understand the illiquid nature of an investment in Secured Investors III [TFSI]. I recognize the risks that such illiquidity entails ..." The Krupp disclosure statement contains this disclaimer: "I fully understand the illiquid nature of an investment in KRUPP CASH PLUS-V and that no secondary market is likely to exist for limited partnership units." Palumbos Aff., Ex. D. The PLM disclosure form contains a similar disclaimer, and notes that "[t]his document only supplements, and in no way replaces the prospectus; investors should review the prospectus closely in order to determine the appropriateness of this investment." *Id.*, Ex. F. It also states that the "program involves special risks in terms of valuation and liquidity for the qualified and IRA plan investor." *Id.* The Berry & Boyle disclosure form contains similar warnings.

These documents indicate clearly that the limited partnerships were not liquid and entailed risks, claims plaintiff now raises. Therefore, when plaintiff signed these documents it triggered a duty of inquiry on her part. *See Topalian v. Ehrman,* 954 F.2d 1125, 1132-34 (5th Cir.) (signing of subscription agreement triggered reason to exercise due diligence), *cert. denied*, 113 S.Ct. 82 (1992). The amended complaint contains no allegation that de-

fendants attempted to conceal the essential facts from plaintiff. On the contrary, the complaint expresses clearly that defendants gave plaintiff all the information necessary for her to make an informed decision, but that plaintiff failed to peruse the information because she could not understand it. This case is, therefore, distinguishable from *McCoy v. Goldberg*, 748 F.Supp. 146 (S.D.N.Y. 1990),[6] a case on which plaintiff relies. Plaintiff attempts to escape the requirement the she exercise reasonable diligence by contending that the Supreme Court's decision in *Lampf* eliminated the objective reasonable diligence standard and substituted in its place a requirement of actual discovery in section 10(b) actions. Plaintiff relies on the Court's statement that "[t]he 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary." *Lampf*, 111 S.Ct. at 2782, and the footnote that states that the governing standard for an action under § 10(b) will be the language of § 9(e) of the 1934 Act, 15 U.S.C. § 78i(e). *Id.* n.9.

I disagree with plaintiff's interpretation of *Lampf*. Courts have long interpreted the term "discovery" to include a requirement of diligence by the defrauded party. For example, the Fifth Circuit, in interpreting the term "discovery" in the statute of limitations provided for in section 29 of the 1934 Act,[7] held that:

> 'Discovery" within the meaning of the statute, 15 U.S.C.A. § 78cc(b), quoted in footnote 2, supra, is to be determined we think, according to an objective standard; that is, 'dis-

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[6] In *McCoy*, the court held that plaintiff, a naive investor, would not be held to have been on constructive notice of the contents of the prospectus, because defendants induced her to ignore the prospectuses.

[7] section 29(b) provided in relevant part:

> [U]nless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

15 U.S.C. §78cc(b).

> covery' means either actual knowledge or notice of facts which, in the exercise of due diligence, would have led to actual knowledge of the violation.

Goldenberg v. Bach and Company, 270 F.2d 675, 681 (5th Cir. 1959) (citing *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946)). The obligation to exercise reasonable diligence is also an essential element of the discovery rule,[5] and is the basis for the objective approach to deciding when the statute of limitation in a securities fraud action accrues. *See Holmberg*, 327 U.S. at 397 (reasonable diligence standard); *Goldenberg,* 270 F.2d at 681 (discovery is to be determined by an objective standard); *Mittendorf*, 372 F.Supp. at 832 (the objective approach has been uniformly applied by Courts in actions brought under both the 1933 and 1934 Securities Acts).

The Court's holding in *Lampf* did not alter this requirement of reasonable diligence. In establishing a uniform statute of limitations the Court stated only that the one-year limitations period begins to run "after discovery of the facts constituting the violation." It did not eliminate the longstanding requirement that a plaintiff exercise reasonable diligence to uncover the fraud. *Anixter v. Home-Stake Production Co.*, 947 F.2d 897, 899 (10th Cir. 1991) ("Anixter II"), *vacated on other grounds and remanded sub nom., Dennler v. Trippet,* 112 S.Ct. 1658 (1992). *But see Werner*, 797 F.Supp. at 1204; *Hauman*, Fed.Sec.L.Rep. ¶ 96,882 at 93,606.

> When the Court selected § 9(e), it did not necessarily indicate a preference for the type of notice of the violation but sought a 'governing' standard to link the implied § 10(b)

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[5] The discovery rule provides essentially that "where a plaintiff has been injured by fraud and 'remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the special circumstances or efforts on the part of the party committing the fraud to conceal it from the knowledge of the other party.' " *Holmberg*, 327 U.S. at 397 (quoting *Bailey v. Glover*, 21 Wall. 342, 348 (1874)).

> remedy to those express securities causes of action which uniformly require one year after notice of the violation and not more than three years after the violation.

Anixter, 947 F.2d at 899 (footnote omitted). Absent a clear indication from the Court that section 10(b) and rule 10b-5 cases are now to be governed by an actual discovery standard, I find that section 10(b) plaintiffs are still required to exercise reasonable diligence to uncover the fraud, and that a failure to do so will result in imputing to them the information that the exercise of reasonable diligence would have uncovered.

Additionally, the Second Circuit's recent interpretation in *Henley v. Slone*, 961 F.2d 23, 24 (2d Cir. 1992) of the uniform statute of limitations it adopted in *Ceres Partners v. GEL Associates*, 918 F.2d 348 (2d Cir. 1990) suggests strongly that the Second Circuit would interpret section 9(e) of the 1934 Act to include a reasonable diligence standard. In *Lampf*, the Supreme Court stated that the language of section 9(e) of the 1934 Act would provide the governing standard for actions under section 10(b). 111 S. Ct. at 2782 n.9. In *Ceres*, the Second Circuit relied, in part, on section 9(e) in its decision to adopt the one-year/three-year limitations period. Recently, in *Henley*, the Second Circuit noted that in *Ceres* "we announced a uniform limitations period of the earlier of one year from the date the fraud was or *reasonably would have been discovered* or three years from the date of the transaction ...". *Henley*, 961 F.2d at 24 (emphasis added). Thus, read together *Henley* and *Ceres* suggest strongly that the Second Circuit has interpreted section 9(e) of the 1934 Act to include a reasonable diligence requirement. *Cf. In re: General Development Corp. Bond Lit.*, No. 91-0594, 1992 U.S. Dist. LEXIS 10245 *18-9 (S.D.N.Y. July 13, 1992) (under the *Henley* court's recapitulation of the *Ceres* rule, courts must consider in section 10(b) actions whether plaintiff should have been alerted to fraud upon receipt of prospectus and other documents).

For the reasons discussed above, I find that plaintiff's federal securities claims under the 1933 and 1934 Acts, which were filed more than one and a half years after plaintiff could have, by the exercise of reasonable diligence, discovered the alleged fraud, are untimely. Although questions of due diligence and constructive knowledge often turn on resolving the disputed facts of a particular case. *Robertson v. Seidman & Seidman*, 609 F.2d 583, 591 (2d Cir. 1979), this action falls within the small category of cases in which it can be said that plaintiff, as a matter of law, should have discovered the alleged fraud more than one year before she commenced the action. *See Davidson*, 973 F.2d at 1401-02. Accordingly, plaintiff's claims under section 12(2) of the 1933 Act, section 10(b) of the 1934 Act, and rule 10b-5 -- counts one and three -- are dismissed under Rule 12(b)(6), Fed.R.Civ.P., as time-barred under the one-year limitations period.

In addition, plaintiff's claims alleging control person, and aider and abettor liability -- counts two and four -- are also dismissed as time-barred. *See Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981) (claims alleging control person liability are governed by same limitations period as primary claims of securities fraud); *Schwartz v. Michaels*, No. 91-3538, 1992 U.S. Dist. LEXIS *52 (S.D.N.Y. July 23, 1992) (limitations period for aiding and abetting liability under section 10(b) is the same as that for primary violation).

III. *The Pendent State Claims*

Jurisdiction over plaintiff's state law claims for breach of fiduciary duty, common law fraud, negligent misrepresentation, and violation of § 349 of the General Business Law of the State of New York are all based solely on pendent jurisdiction; there is no independent source of federal jurisdiction. Because all of the federal claims have been dismissed, I decline to retain jurisdiction over the state law claims. Accordingly, Counts five through

eleven are dismissed, without prejudice, for lack of subject matter jurisdiction.

IV. *Leave to Replead*

Plaintiff has moved for leave to file a second amended complaint if her amended complaint is dismissed. Because plaintiff's federal securities law claims are dismissed as time-barred, and her state law claims are dismissed without prejudice, there is no basis to allow plaintiff to replead. Amendment of the complaint will not cure its defects. Consequently, plaintiff's motion is denied.

CONCLUSION

For the reasons set forth above, defendants' motion to dismiss the amended complaint is granted, and the complaint is dismissed. Plaintiff's motion to amend the complaint is denied.

IT IS SO ORDERED.

DAVID G. LARIMER
UNITED STATES DISTRICT JUDGE

Dated: Rochester, New York
December 15, 1992.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

MARY E. DODDS,

Plaintiff,

-vs- 92-CV-6053L

CIGNA SECURITIES, INC., et al.,

Defendants.

Take notice of a Judgment of which the within is a copy, duly granted in the within entitled action on the 16th day of December, 1992 and entered in the office of the Clerk of the United States District Court, Western District of New York, on the 16th day of December, 1992.

Dated: Rochester, New York
December 16, 1992

RODNEY C. EARLY, Clerk
U.S. District Court
Western District of New York
282 U.S. Courthouse
Rochester, New York 14614

TO: Carolyn Nussbaum, Esq.
Cathy Bardenstein, Esq.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

JUDGMENT IN A CIVIL CASE

MARY E. DODDS

V.

CIGNA SECURITIES, INC., CIGNA INDIVIDUAL FINANCIAL SERVICES COMPANY, INC., CONNECTICUT GENERAL LIFE INSURANCE COMPANY CIGNA CORPORATION and MARTIN F. PALUMBOS

CASE NUMBER: 92-CV-6053L

☐ **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ **Decision by Court.** This action came to hearing before the Court. The issues have been heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the complaint is dismissed.

December 16, 1992
Date

RODNEY C. EARLY
Clerk
s/Janet E. Mulley
JANET E. MULLEY
(By) Deputy Clerk

17 C.F.R. § 240.10B-5

RULE 10b-5

EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.